



COLORADO

**Department of
Regulatory Agencies**

**2014 Sunset Review:
Colorado Division of Securities and the
Colorado Securities Board**

*Office of Policy, Research and Regulatory Reform
October 15, 2014*



COLORADO

**Department of
Regulatory Agencies**

Executive Director's Office

October 15, 2014

Members of the Colorado General Assembly
c/o the Office of Legislative Legal Services
State Capitol Building
Denver, Colorado 80203

Dear Members of the General Assembly:

The mission of the Department of Regulatory Agencies (DORA) is consumer protection. As a part of the Executive Director's Office within DORA, the Office of Policy, Research and Regulatory Reform seeks to fulfill its statutorily mandated responsibility to conduct sunset reviews with a focus on protecting the health, safety and welfare of all Coloradans.

DORA has completed the evaluation of the Colorado Division of Securities (Division) and the Colorado Securities Board. I am pleased to submit this written report, which will be the basis for my office's oral testimony before the 2015 legislative committee of reference. The report is submitted pursuant to section 24-34-104(8)(a), of the Colorado Revised Statutes (C.R.S.), which states in part:

The department of regulatory agencies shall conduct an analysis of the performance of each division, board or agency or each function scheduled for termination under this section...

The department of regulatory agencies shall submit a report and supporting materials to the office of legislative legal services no later than October 15 of the year preceding the date established for termination....

The report discusses the question of whether there is a need for the regulation provided under Article 51 of Title 11, C.R.S. The report also discusses the effectiveness of the Division and staff in carrying out the intent of the statutes and makes recommendations for statutory changes in the event this regulatory program is continued by the General Assembly.

Sincerely,

Barbara J. Kelley
Executive Director





COLORADO

Department of Regulatory Agencies

2014 Sunset Review

Colorado Division of Securities and the Colorado Securities Board

SUMMARY

What Is It Regulated?

The Colorado Securities Act (Act) provides regulatory oversight of broker-dealers, sales representatives, investment advisors (IAs) and investment advisor representatives (IARs). The Act also requires securities to be registered, unless exempt, with the Colorado Division of Securities (Division).

Why Is It Regulated?

The purpose of the Act is to provide protection to consumers by requiring securities to be registered with the Division and broker-dealers, sales representatives, IAs and IARs to be licensed. The Division periodically audits the aforementioned licensed entities to ensure they are complying with the Act. A periodic audit of licensees attempts to limit dishonest and unethical sales practices.

How Is It Regulated?

The Act is enforced by the Securities Commissioner. The Securities Commissioner is responsible for, among other things, imposing discipline, rulemaking and policymaking. The Colorado Securities Board (Board) is responsible for providing oversight and advice to the Securities Commissioner in the execution of his duties, and for holding hearings in certain disciplinary proceedings.

What Does It Cost?

In fiscal year 12-13, the Division's total expenditures were \$4,064,974. There were 26.0 full-time equivalent employees to provide regulatory oversight.

What Disciplinary Activity Is There?

Between fiscal years 08-09 and 12-13, there were a total of 806 final dispositions ordered by the Securities Commissioner. Final dispositions include, but are not limited to: cease and desist and restitution orders.

KEY RECOMMENDATIONS

Continue the Division and the Board for 11 years, until 2026.

The first sunset review criterion asks whether regulation is necessary to protect the health, safety and welfare of the public. The securities industry is complex, and there are huge amounts of investor funds that can be vulnerable to risks such as fraud. As such, a comprehensive regulatory structure is essential. The regulatory structure in Colorado does serve to provide adequate protection to consumers. The current system of regulation in Colorado, including the utilization of the Board, is working well and provides adequate and appropriate protection to consumers in the securities marketplace.

Require securities offered in Colorado pursuant to federal Regulation A of the Securities Act of 1933 to be registered by coordination.

Currently, securities offered in Colorado pursuant to Regulation A of the Securities Act of 1933 are exempt from registration. Specifically, section 11-51-308(1)(p), Colorado Revised Statutes, (C.R.S.), provides an exemption from registration by requiring the issuer of the securities to provide notice to the Division that the securities are being offered in Colorado and pay the applicable fee.

However, the Jobs Act of 2012, which was enacted by Congress, amended Regulation A by increasing the annual offering limits for securities issued from \$5 million to \$50 million. The substantial increase in the dollar amount issued under Regulation A increases the potential financial risk to Colorado investors. As a result, Regulation A offerings in Colorado should be required to register with the Division. Doing so would enable Division staff to proactively review securities that are offered to investors under Regulation A.

MAJOR CONTACTS MADE DURING THIS REVIEW

Colorado Attorney General's Office
Colorado Bar Association Business Section - Securities Sub-Section
Colorado Division of Securities Staff
Colorado Securities Board Members
Financial Industry Regulatory Authority
North American Securities Administrators Association
Securities and Exchange Commission
United States Attorney's Office

What is a Sunset Review?

A sunset review is a periodic assessment of state boards, programs, and functions to determine whether they should be continued by the legislature. Sunset reviews focus on creating the least restrictive form of regulation consistent with protecting the public. In formulating recommendations, sunset reviews consider the public's right to consistent, high quality professional or occupational services and the ability of businesses to exist and thrive in a competitive market, free from unnecessary regulation.

Sunset Reviews are prepared by:
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Background

Introduction

Enacted in 1976, Colorado's sunset law was the first of its kind in the United States. A sunset provision repeals all or part of a law after a specific date, unless the legislature affirmatively acts to extend it. During the sunset review process, the Department of Regulatory Agencies (DORA) conducts a thorough evaluation of such programs based upon specific statutory criteria¹ and solicits diverse input from a broad spectrum of stakeholders including consumers, government agencies, public advocacy groups, and professional associations.

Sunset reviews are based on the following statutory criteria:

- Whether regulation by the agency is necessary to protect the public health, safety and welfare; whether the conditions which led to the initial regulation have changed; and whether other conditions have arisen which would warrant more, less or the same degree of regulation;
- If regulation is necessary, whether the existing statutes and regulations establish the least restrictive form of regulation consistent with the public interest, considering other available regulatory mechanisms and whether agency rules enhance the public interest and are within the scope of legislative intent;
- Whether the agency operates in the public interest and whether its operation is impeded or enhanced by existing statutes, rules, procedures and practices and any other circumstances, including budgetary, resource and personnel matters;
- Whether an analysis of agency operations indicates that the agency performs its statutory duties efficiently and effectively;
- Whether the composition of the agency's board or commission adequately represents the public interest and whether the agency encourages public participation in its decisions rather than participation only by the people it regulates;
- The economic impact of regulation and, if national economic information is not available, whether the agency stimulates or restricts competition;
- Whether complaint, investigation and disciplinary procedures adequately protect the public and whether final dispositions of complaints are in the public interest or self-serving to the profession;
- Whether the scope of practice of the regulated occupation contributes to the optimum utilization of personnel and whether entry requirements encourage affirmative action;

¹ Criteria may be found at § 24-34-104, C.R.S.

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- Whether the agency through its licensing or certification process imposes any disqualifications on applicants based on past criminal history and, if so, whether the disqualifications serve public safety or commercial or consumer protection interests. To assist in considering this factor, the analysis prepared pursuant to subparagraph (i) of paragraph (a) of subsection (8) of this section shall include data on the number of licenses or certifications that were denied, revoked, or suspended based on a disqualification and the basis for the disqualification; and
 - Whether administrative and statutory changes are necessary to improve agency operations to enhance the public interest.

Types of Regulation

Consistent, flexible, and fair regulatory oversight assures consumers, professionals and businesses an equitable playing field. All Coloradans share a long-term, common interest in a fair marketplace where consumers are protected. Regulation, if done appropriately, should protect consumers. If consumers are not better protected and competition is hindered, then regulation may not be the answer.

As regulatory programs relate to individual professionals, such programs typically entail the establishment of minimum standards for initial entry and continued participation in a given profession or occupation. This serves to protect the public from incompetent practitioners. Similarly, such programs provide a vehicle for limiting or removing from practice those practitioners deemed to have harmed the public.

From a practitioner perspective, regulation can lead to increased prestige and higher income. Accordingly, regulatory programs are often championed by those who will be the subject of regulation.

On the other hand, by erecting barriers to entry into a given profession or occupation, even when justified, regulation can serve to restrict the supply of practitioners. This not only limits consumer choice, but can also lead to an increase in the cost of services.

There are also several levels of regulation.

Licensure

Licensure is the most restrictive form of regulation, yet it provides the greatest level of public protection. Licensing programs typically involve the completion of a prescribed educational program (usually college level or higher) and the passage of an examination that is designed to measure a minimal level of competency. These types of programs usually entail title protection - only those individuals who are properly licensed may use a particular title(s) - and practice exclusivity - only those individuals who are properly licensed may engage in the particular practice. While these requirements can be viewed as barriers to entry, they also afford the highest level of consumer protection in that they ensure that only those who are deemed competent may practice and the public is alerted to those who may practice by the title(s) used.

Certification

Certification programs offer a level of consumer protection similar to licensing programs, but the barriers to entry are generally lower. The required educational program may be more vocational in nature, but the required examination should still measure a minimal level of competency. Additionally, certification programs typically involve a non-governmental entity that establishes the training requirements and owns and administers the examination. State certification is made conditional upon the individual practitioner obtaining and maintaining the relevant private credential. These types of programs also usually entail title protection and practice exclusivity.

While the aforementioned requirements can still be viewed as barriers to entry, they afford a level of consumer protection that is lower than a licensing program. They ensure that only those who are deemed competent may practice and the public is alerted to those who may practice by the title(s) used.

Registration

Registration programs can serve to protect the public with minimal barriers to entry. A typical registration program involves an individual satisfying certain prescribed requirements - typically non-practice related items, such as insurance or the use of a disclosure form - and the state, in turn, placing that individual on the pertinent registry. These types of programs can entail title protection and practice exclusivity. Since the barriers to entry in registration programs are relatively low, registration programs are generally best suited to those professions and occupations where the risk of public harm is relatively low, but nevertheless present. In short, registration programs serve to notify the state of which individuals are engaging in the relevant practice and to notify the public of those who may practice by the title(s) used.

Title Protection

Finally, title protection programs represent one of the lowest levels of regulation. Only those who satisfy certain prescribed requirements may use the relevant prescribed title(s). Practitioners need not register or otherwise notify the state that they are engaging in the relevant practice, and practice exclusivity does not attach. In other words, anyone may engage in the particular practice, but only those who satisfy the prescribed requirements may use the enumerated title(s). This serves to indirectly ensure a minimal level of competency - depending upon the prescribed preconditions for use of the protected title(s) - and the public is alerted to the qualifications of those who may use the particular title(s).

Licensing, certification and registration programs also typically involve some kind of mechanism for removing individuals from practice when such individuals engage in enumerated proscribed activities. This is generally not the case with title protection programs.

Regulation of Businesses

Regulatory programs involving businesses are typically in place to enhance public safety, as with a salon or pharmacy. These programs also help to ensure financial solvency and reliability of continued service for consumers, such as with a public utility, a bank or an insurance company.

Activities can involve auditing of certain capital, bookkeeping and other recordkeeping requirements, such as filing quarterly financial statements with the regulator. Other programs may require onsite examinations of financial records, safety features or service records.

Although these programs are intended to enhance public protection and reliability of service for consumers, costs of compliance are a factor. These administrative costs, if too burdensome, may be passed on to consumers.

Sunset Process

Regulatory programs scheduled for sunset review receive a comprehensive analysis. The review includes a thorough dialogue with agency officials, representatives of the regulated profession and other stakeholders. Anyone can submit input on any upcoming sunrise or sunset review via DORA's website at: www.dora.colorado.gov/opr.

The regulatory functions of the Colorado Division of Securities (Division), under the administration of the Securities Commissioner, and the Colorado Securities Board (Board) as enumerated in Article 51 of Title 11, Colorado Revised Statutes (C.R.S.), shall terminate on July 1, 2015, unless continued by the General Assembly. During the year prior to this date, it is the duty of DORA to conduct an analysis and evaluation of the administration of the Division and the Board pursuant to section 24-34-104, C.R.S.

The purpose of this review is to determine whether the currently prescribed regulation of the securities industry should be continued for the protection of the public and to evaluate the performance of the Division and Board. During this review, the Division must demonstrate that the regulation serves to protect the public health, safety or welfare, and that the regulation is the least restrictive regulation consistent with protecting the public. DORA's findings and recommendations are submitted via this report to the Office of Legislative Legal Services.

Methodology

As part of this review, DORA staff attended Board meetings, interviewed Division staff, reviewed Division records and minutes including complaint and disciplinary actions, interviewed officials with state and national professional associations, reviewed Colorado statutes and Division rules, and reviewed the laws of other states.

Profile of the Profession

In Colorado, the Division and Board provide regulatory oversight of the securities industry. Specifically, the Division and Board, among other things, regulate broker-dealers (firms) and sales representatives, investment advisors (IAs), and investment advisor representatives (IARs).

Securities include financial instruments that represent: an ownership position in a corporation (stock), a creditor relationship with a government body or a corporation (bond) or putative rights to ownership as represented by an option.²

The company or entity that issues a security is known as the issuer. For example, the issuer of a bond may be a municipal government raising funds for a particular project.³

Additionally, securities are typically divided into two categories: debt and equities. A debt security is a type of security that represents money that is borrowed and must be repaid, with terms that define the amount borrowed, interest rate and maturity/renewal date.⁴ Debt securities include government and corporate bonds, certificates of deposit (CDs) and preferred stock.⁵ Preferred stock pays a fixed dividend that usually does not fluctuate.⁶

Equities represent ownership interest held by shareholders in a corporation, such as a stock,⁷ as well as ownership interests in other entities such as partnerships. Unlike holders of debt securities that generally receive only interest and the repayment of the principal, holders of equity securities are entitled to profit from capital gains,⁸ as well as other benefits. One form of capital gains is the amount by which an asset's (e.g., stock or real property) current market price exceeds its initial purchase price.⁹

² Investopedia. *Definition of Security*. Retrieved August 7, 2014, from <http://www.investopedia.com/terms/s/security.asp>

³ Investopedia. *Definition of Security*. Retrieved August 7, 2014, from <http://www.investopedia.com/terms/s/security.asp>

⁴ Investopedia. *Definition of Security*. Retrieved August 7, 2014, from <http://www.investopedia.com/terms/s/security.asp>

⁵ Investopedia. *Definition of Security*. Retrieved August 7, 2014, from <http://www.investopedia.com/terms/s/security.asp>

⁶ Investorguide.com. *Common Stock vs. Preferred Stock, and Stock Classes*. Retrieved August 8, 2014, from, <http://www.investorguide.com/article/11166/stock-classes-the-difference-between-common-stock-and-preferred-stock-igu/>

⁷ Investopedia. *Definition of Security*. Retrieved August 7, 2014, from <http://www.investopedia.com/terms/s/security.asp>

⁸ Investopedia. *Definition of Security*. Retrieved August 7, 2014, from <http://www.investopedia.com/terms/s/security.asp>

⁹ Investorwords. *Capital Gain*. Retrieved August 8, 2014, from http://www.investorwords.com/706/capital_gain.html

Broker-dealers (firms) and the sales representatives (individuals), most commonly known as stockbrokers, make recommendations about specific investments like stocks, bonds or mutual funds.¹⁰ Stockbrokers generally do not give consumers detailed financial plans.¹¹ Instead, stockbrokers facilitate securities transactions on behalf of their clients.

Generally, there are two types of broker-dealers: discount and full-service. Discount broker-dealers charge lower fees and commissions for their services, but, in most cases, consumers must research and choose their own investments.¹²

Full-service broker-dealers cost more, but the higher fees and commissions pay for a broker-dealer's investment advice based on the firm's research.¹³

Additionally, IAs, for a fee, provide advice to customers about investing in securities.¹⁴ The Division and Board regulate IAs with less than \$100 million in assets under management, while the Securities and Exchange Commission regulates IAs with more than \$100 million in assets under management.¹⁵

IARs are individuals who work for IAs and provide investment advisory services to consumers.¹⁶ For instance, IARs give advice on investing in stocks, bonds, mutual funds or exchange traded funds.¹⁷

¹⁰ U.S. Securities and Exchange Commission. *How to Pick a Financial Professional*. Retrieved August 7, 2014, from <http://www.sec.gov/investor/pubs/roadmap/pick.htm>

¹¹ U.S. Securities and Exchange Commission. *How to Pick a Financial Professional*. Retrieved August 7, 2014, from <http://www.sec.gov/investor/pubs/roadmap/pick.htm>

¹² U.S. Securities and Exchange Commission. *How to Pick a Financial Professional*. Retrieved August 7, 2014, from <http://www.sec.gov/investor/pubs/roadmap/pick.htm>

¹³ U.S. Securities and Exchange Commission. *How to Pick a Financial Professional*. Retrieved August 7, 2014, from <http://www.sec.gov/investor/pubs/roadmap/pick.htm>

¹⁴ Department of Regulatory Agencies. *Colorado Investment Adviser Law*. Retrieved August 7, 2014, from <http://cdn.colorado.gov/cs/Satellite?c=Page&childpagename=DORA-SD%2FDORALayout&cid=1251628725711&pagename=CBONWrapper>

¹⁵ Department of Regulatory Agencies. *Colorado Investment Adviser Law*. Retrieved August 7, 2014, from <http://cdn.colorado.gov/cs/Satellite?c=Page&childpagename=DORA-SD%2FDORALayout&cid=1251628725711&pagename=CBONWrapper>

¹⁶ Department of Regulatory Agencies. *Colorado Investment Adviser Law*. Retrieved August 7, 2014, from <http://cdn.colorado.gov/cs/Satellite?c=Page&childpagename=DORA-SD%2FDORALayout&cid=1251628725711&pagename=CBONWrapper>

¹⁷ U.S. Securities and Exchange Commission. *Investment Advisors: What You Need to Know Before Choosing One*. Retrieved August 7, 2014, from <http://www.sec.gov/investor/pubs/invadvisers.htm>

Legal Framework

History of Regulation

The securities industry has been regulated in the United States since 1911, with the passage of the first securities law in Kansas.¹⁸ By 1919, 32 states had passed their own securities laws.¹⁹

In Colorado, the General Assembly passed the first securities statute in 1923, and has regulated the securities industry ever since.²⁰ In an attempt to provide enhanced protection to consumers, the regulation of the securities industry has continually evolved. The Department of Regulatory Agencies conducted sunset reviews in 1993 and 2003 on the Colorado Division of Securities (Division) and the Colorado Securities Board (Board).

Federal Laws

There are several federal laws that influence the regulation of securities, including but not limited to:

- Securities Act of 1933 ('33 Act);
- Securities Exchange Act of 1934 ('34 Act);
- Investment Advisors Act of 1940;
- Investment Company Act of 1940;
- National Securities Markets Improvement Act of 1996;
- Gramm-Leach-Bliley Financial Modernization Act of 1999 (Gramm-Leach-Bliley Act of 1999); and
- Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act).

¹⁸ Department of Regulatory Agencies. 2003 Colorado Division of Securities and Colorado Securities Board Sunset Review. p.2.

¹⁹ Department of Regulatory Agencies. 2003 Colorado Division of Securities and Colorado Securities Board Sunset Review. p.2.

²⁰ Department of Regulatory Agencies. 2003 Colorado Division of Securities and Colorado Securities Board Sunset Review. p.2.

The '33 Act was the first major piece of federal legislation focused on the sale of securities.²¹ Prior to the passage of the '33 Act, state laws primarily governed the sale of securities.²² However, the stock market crash of 1929 raised questions about the effectiveness of how the markets were being governed.²³ The '33 Act addressed the need for better disclosure by requiring companies to register with the Securities and Exchange Commission (SEC).²⁴ Registering ensures companies provide the SEC and potential investors with all relevant information by means of the prospectus and disclosure requirements.²⁵

The '34 Act was created to provide governance of securities transactions on the secondary market (after issue) and regulate the exchanges and broker-dealers in order to protect the investing public.²⁶

The Investment Advisors Act of 1940, among other things, defined the role and responsibilities of an investment advisor.²⁷ A subsequent amendment to the act stipulated that investment advisors with more than \$25 million under management were required to register with the SEC.²⁸ Investment advisors with less than \$25 million under management only have to register with their state.²⁹ Under revisions pursuant to the Dodd-Frank Act, the SEC jurisdictional amount was increased to \$100 million or more of assets under management. Accordingly, state regulatory authority was increased to include investment advisors with less than \$100 million of assets under management.

The Investment Company Act of 1940, among other things, prescribes how investment companies must handle changes in their investment policies and the consequences in the event of fraud or breach of fiduciary duty.³⁰

The National Securities Markets Improvement Act of 1996 was an effort to update and amend previous security acts and create one uniform code that companies and regulators could follow.³¹

²¹ Investopedia.com. *Securities Act of 1933 Definition*. Retrieved August 7, 2014, from <http://www.investopedia.com/terms/s/securitiesact1933.asp>

²² Investopedia.com. *Securities Act of 1933 Definition*. Retrieved August 7, 2014, from <http://www.investopedia.com/terms/s/securitiesact1933.asp>

²³ Investopedia.com. *Securities Act of 1933 Definition*. Retrieved August 7, 2014, from <http://www.investopedia.com/terms/s/securitiesact1933.asp>

²⁴ Investopedia.com. *Securities Act of 1933 Definition*. Retrieved August 7, 2014, from <http://www.investopedia.com/terms/s/securitiesact1933.asp>

²⁵ Investopedia.com. *Securities Act of 1933 Definition*. Retrieved August 7, 2014, from <http://www.investopedia.com/terms/s/securitiesact1933.asp>

²⁶ Investopedia.com. *Securities Exchange Act of 1934 Definition*. Retrieved August 11, 2014, from <http://www.investopedia.com/terms/s/seact1934.asp>

²⁷ Investopedia.com. *Investment Advisors Act of 1940 Definition*. Retrieved August 11, 2014, from <http://www.investopedia.com/terms/i/investadvact.asp>

²⁸ Investopedia.com. *Investment Advisors Act of 1940 Definition*. Retrieved August 11, 2014, from <http://www.investopedia.com/terms/i/investadvact.asp>

²⁹ Investopedia.com. *Investment Advisors Act of 1940 Definition*. Retrieved August 11, 2014, from <http://www.investopedia.com/terms/i/investadvact.asp>

³⁰ Investopedia.com. *Investment Company Act of 1940 Definition*. Retrieved August 11, 2014, from <http://www.investopedia.com/terms/i/investmentcompanyact.asp>

The Gramm-Leach-Bliley Act of 1999 repealed the Glass-Steagall Act that prohibited banks and other financial institutions from offering financial services such as investments and insurance-related services.³²

The Dodd-Frank Act contained many significant changes to the regulation of the financial industry in the United States. For example, the Dodd-Frank Act, among other things, authorizes the SEC to issue rules requiring broker-dealers to provide particular information before the purchase of an investment product or service by a retail investor.³³ The requirements include information about investment objectives, strategies, costs and risks, as well as the compensation and other financial incentives of the broker-dealers and any intermediary.³⁴

State Law

The Colorado Securities Act (Act) is created in section 11-51-101, *et seq.*, Colorado Revised Statutes (C.R.S.), and contains nine parts. The Division, including the Securities Commissioner and the Board, are responsible for providing regulatory oversight.

The Securities Commissioner is also responsible for providing regulatory oversight for the Colorado Commodity Code (section 11-53-101, *et seq.*, C.R.S.), the Colorado Municipal Bond Supervision Act (section 11-59-101, *et seq.*, C.R.S.), and Investment Funds (section 24-75-701, *et seq.*, C.R.S.).

The purpose of the Act is to protect investors and maintain public confidence in securities markets while avoiding unreasonable burdens in capital markets.³⁵ Generally, the Act accomplishes public protection by requiring the registration of securities and regulating broker-dealers, investment advisors and their representatives.

³¹ Investopedia.com *National Securities Markets Improvement Act - NSMIA Definition*. Retrieved August 12, 2014, from <http://www.investopedia.com/terms/n/nsmia.asp>

³² Investopedia.com. *Gramm-Leach-Bliley Act of 1999 - GLBA Definition*. Retrieved August 12, 2014, from <http://www.investopedia.com/terms/g/glba.asp>

³³ The Harvard Law School Forum on Corporate Governance and Financial Regulation. *Investor Protection Provisions of the Dodd-Frank Act*. Retrieved August 12, 2014, from <http://blogs.law.harvard.edu/corpgov/2010/07/11/investor-protection-provisions-of-the-dodd-frank-act/>

³⁴ The Harvard Law School Forum on Corporate Governance and Financial Regulation. *Investor Protection Provisions of the Dodd-Frank Act*. Retrieved August 12, 2014, from <http://blogs.law.harvard.edu/corpgov/2010/07/11/investor-protection-provisions-of-the-dodd-frank-act/>

³⁵ § 11-51-101(2), C.R.S.

The Act defines securities as,

Any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate of subscription, transferable share, investment contract, viatical settlement investment, voting-trust certificate, certificate of deposit for a security, certificate of interest or participation in an oil, gas or mining title or lease or in payments out of production under such a title or lease, or, in general, any interest or instrument commonly known as a “security” or any certificate of interest or participation in, temporary or interim certificate for, guarantee of, or warrant or right to subscribe to or purchase any of the foregoing. Security does not include any insurance or endowment policy or annuity contract under which an insurance company promises to pay a sum of money either in a lump sum or periodically for life or some other specified period. For purposes of [the Act], an “investment contract” need not involve more than one investor nor be limited to those circumstances wherein there are multiple investors who are joint participants in the same enterprise.³⁶

While the Act requires issuers to register their securities with the Division, the Act also provides a number of exemptions from registration. The exemptions generally apply to securities associated with banks, insurance companies or governmental entities. Other exemptions from the registration requirement include, but are not limited to:³⁷

- Any security issued or guaranteed by any federal credit union or any credit union, industrial loan association or similar association organized and supervised under the laws of the State of Colorado;
- Any security listed or approved for listing upon notice of issuance on any national securities exchange registered by the federal '34 Act; and
- Any security that is issued by any person organized and operated not for private profit but exclusively for religious, educational, benevolent or charitable purposes or as a chamber of commerce or trade or professional association and which is offered or sold to a bona fide constituent or member of such organization or association.

³⁶ § 11-51-201(17), C.R.S.

³⁷ §§ 11-51-307(1)(d),(f) and (g), C.R.S.

The Act also highlights a number of exemptions related to certain securities transactions, such as:³⁸

- Any transaction by an executor, administrator, sheriff, marshal, receiver trustee in bankruptcy, guardian or conservator;
- Any offer or sale to a financial or institutional investor or to a broker-dealer, whether the purchaser is acting for itself or in some fiduciary capacity; or
- Any transaction not involving a public offering.

Securities that do not fall under the myriad of exemptions must be registered. There are generally three avenues by which securities can be registered:

- Coordination;
- Qualification; and
- Limited offering.

Registration by coordination can be completed if the securities are registered with the SEC. A registration statement and accompanying records must be filed with the Securities Commissioner.³⁹ The information required to be submitted to the Securities Commissioner is as follows:⁴⁰

- A copy of the latest form of prospectus;
- A current copy of the issuer's articles of incorporation and bylaws;
- A copy of any agreement with or among the underwriters of the security;
- A copy of the indenture or other instrument governing the issuance of the security;
- A copy or description of the security; and
- A copy of any other information or records filed with the SEC.

Securities registered by qualification usually indicates that the securities have not been registered with the SEC. Registration by qualification must include a registration statement containing full and fair disclosure of all material facts respecting the investment offered, including, without limitation, the title of the security, and the number or amount being registered.⁴¹

³⁸ §§ 11-51-308(1)(f), (h) and (i), C.R.S.

³⁹ § 11-51-303(1), C.R.S.

⁴⁰ §§ 11-51-303(1)(a), (b) and (c), C.R.S.

⁴¹ § 11-51-304(2), C.R.S.

Securities registered by qualification must include the additional following information:⁴²

- The issuer's name, address and form of organization;
- The state or foreign jurisdiction and date of its organization;
- The general character and location of its business;
- A description of its physical properties and equipment; and
- A statement of the general competitive conditions in the industry or business in which it is or will be engaged.

Limited offering registration is a type of small public offering for firms to issue securities, for example, to raise business capital. A limited offering registration is authorized if the issuer has its principal office and the majority of its full-time employees in Colorado.⁴³ Also, the issuer must provide information evidencing that at least 80 percent of the net proceeds from the offering will be used in connection with the operations of business in Colorado.⁴⁴

The gross proceeds from a limited offering, together with any other securities offerings by the issuer, cannot exceed \$5 million within any 12-month period.⁴⁵

A limited offering registration must include specified information submitted to the Division, including but not limited to:⁴⁶

- The principal business address of the issuer; and
- The general character and location of its business and a description of its physical properties and equipment.

Broker-Dealers and Sales Representatives

Broker-dealers can be either individuals or businesses. Section 11-51-201(2), C.R.S., defines "broker-dealer" as a person engaged in the business of effecting purchases or sales of securities for the accounts of others in the business of purchasing and selling securities for a person's own account.

⁴² § 11-51-304(2)(a), C.R.S.

⁴³ § 11-51-304(6), C.R.S.

⁴⁴ § 11-51-304(6), C.R.S.

⁴⁵ § 11-51-304(6), C.R.S.

⁴⁶ §§ 11-51-304(6)(a) and (b), C.R.S.

Broker-dealers that operate in multiple states, including Colorado, are required to complete a "Form BD (Uniform Application for Broker-Dealer Registration)," which is a registration form utilized by the Financial Industry Regulatory Authority (FINRA). The form is electronically submitted through the Central Registration Depository (CRD). The CRD is a national computerized licensing system that is operated by FINRA, the SEC and state regulators. FINRA maintains the CRD. Once complete, broker-dealers must pay the applicable licensing fee, which is currently \$80.⁴⁷

Broker-dealers that conduct business exclusively in Colorado are required to submit a Form BD to the Securities Commissioner.⁴⁸

A sales representative is defined in section 11-51-201(14), C.R.S., as

an individual, other than a broker-dealer, either authorized to act and acting for a broker-dealer in effecting or attempting to effect purchases or sales of securities or authorized to act and acting for an issuer in effecting or attempting to effect purchases or sales of the issuer's own securities.

To obtain a sales representative license to conduct business in multiple states, a candidate must complete a FINRA "Form U-4" (Uniform Application for Securities Industry Registration) designating Colorado as the recipient of the filing.⁴⁹ The Form U-4 must be submitted through the CRD. Once complete, a candidate is required to pay the licensing fee, which is currently \$16.⁵⁰

Sales representatives who conduct business exclusively in Colorado are required to submit a Form U-4 to the Securities Commissioner.⁵¹ Sales representatives must also successfully complete the Uniform Securities Agent State Law examination (Series 63) administered through FINRA.⁵²

⁴⁷ Department of Regulatory Agencies. *Fee Schedule*. Retrieved August 19, 2014, from <http://cdn.colorado.gov/cs/Satellite?c=Page&childpagename=DORA-SD%2FDORALayout&cid=1251624413826&pagename=CBONWrapper>

⁴⁸ Department of Regulatory Agencies, Division of Securities. Rules Under the Colorado Securities Act. Rule 51-4.1C.

⁴⁹ Department of Regulatory Agencies. *SEC/FINRA Licensing Procedure*. Retrieved August 19, 2014, from <http://cdn.colorado.gov/cs/Satellite/DORA-SD/CBON/DORA/1251628487386>

⁵⁰ Department of Regulatory Agencies. *Fee Schedule*. Retrieved August 19, 2014, from <http://cdn.colorado.gov/cs/Satellite?c=Page&childpagename=DORA-SD%2FDORALayout&cid=1251624413826&pagename=CBONWrapper>

⁵¹ Department of Regulatory Agencies, Division of Securities. Rules Under the Colorado Securities Act. Rule 51-4.3C.

⁵² Department of Regulatory Agencies, Division of Securities. Rules Under the Colorado Securities Act. Rule 51-4.3E.

Investment Advisors and Investment Advisor Representatives

Investment advisors (IAs) are defined in section 11-51-201(9.5)(a)(I), C.R.S., as:

any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing or selling securities, or who for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities.

The term “investment advisor” includes financial planners or other persons who, as an integral component of other financially related services, provide investment advisory services to others for compensation.⁵³

The SEC regulates IAs with more than \$100 million in assets under management, and the Division and Board regulate IAs located in Colorado with less than \$100 million in assets under management.⁵⁴

In order to obtain a license from the Division, IAs must submit an application (Form ADV - Uniform Application for Investment Advisor Registration) through the Investment Advisor Registration Depository (IARD). The IARD is an electronic filing system sponsored by the SEC and North American Securities Administrators Association (NASAA), with FINRA serving as the developer and operator of the system.⁵⁵

In Colorado, the Act also requires investment advisor representatives (IARs) to secure a license from the Securities Commissioner. Investment advisor representatives must submit an application (U-4 - Uniform Application for Securities Industry Registration) for licensure through the IARD. Generally, a candidate for licensure must pass a Series 65 Examination - Uniform Investment Advisor Law Examination, which is administered by the NASAA, within a two-year period immediately preceding the date of the application for licensing.⁵⁶

All IAs and IARs are required to furnish a written disclosure statement to each prospective client and to each client who is to receive IA services.⁵⁷

⁵³ § 11-51-201(9.5)(a)(II), C.R.S.

⁵⁴ Department of Regulatory Agencies. *Colorado Investment Adviser Law*. Retrieved August 7, 2014, from <http://cdn.colorado.gov/cs/Satellite?c=Page&childpagename=DORA-SD%2FDORALayout&cid=1251628725711&pagename=CBONWrapper>

⁵⁵ Investment Advisor Registration Depository. *What is IARD?* Retrieved August 19, 2014, from <http://www.iard.com/WhatIsIARD.asp>

⁵⁶ Department of Regulatory Agencies, Division of Securities. Rules Under the Colorado Securities Act. Rule 51-4.4(IA)E.

⁵⁷ § 11-51-409.5(1), C.R.S.

Securities Board

The Board consists of five members—three professional members and two public members. The Governor, subject to consent and approval of the Senate, appoints all Board members.⁵⁸

Specifically, the composition of the Board is as follows:⁵⁹

- Two Board members must be licensed attorneys who are conversant in securities law;
- One Board member must be a certified accountant; and
- Two Board members must be public members.

The Board, among other things, is tasked with advising the Securities Commissioner on issues affecting the Division, including securities regulations.⁶⁰

The Board chair is authorized to appoint a hearing panel consisting of no less than three Board members to conduct hearings on the issuance of cease and desist orders, summary orders and registration suspensions.⁶¹

Securities Commissioner

The Securities Commissioner is authorized to administer the Act, including but not limited to: registering securities, issuing licenses to broker-dealers, investment advisors and their representatives and imposing discipline. The Securities Commissioner has a variety of disciplinary options, such as issuing cease and desist orders. The Securities Commissioner may deny an application for license, suspend or revoke a license, censure a licensed person and limit or impose conditions on the securities activities of a licensee.⁶²

In addition to the Act, the Securities Commissioner is responsible for administering and enforcing the provisions of the following statutes:

- Local Government Investment Pool Trust Fund Administration and Enforcement Act;
- Colorado Commodity Code (Code); and
- Colorado Municipal Bond Supervision Act (Bond Supervision Act).

⁵⁸ § 11-51-702.5(1), C.R.S.

⁵⁹ §§ 11-51-702.5(1)(a),(b) and (c), C.R.S.

⁶⁰ § 11-51-702.5(4), C.R.S.

⁶¹ § 11-51-702.5(6)(c), C.R.S.

⁶² § 11-51-410(1), C.R.S.

The Local Government Investment Pool Trust Fund Administration and Enforcement Act is located in Part 9 of the Act, and its purpose is to authorize the Securities Commissioner to have regulatory oversight of local governments that pool their financial resources to, among other things, enjoy greater diversity of investments.

Local government investment pools are required to be registered with the Division.⁶³ The information required in the local government trust fund notice for registration, includes but is not limited to:⁶⁴

- The name and address of the trust fund;
- The name and address of the administrator of the trust fund;
- The name and address of each of the custodians of the assets of the trust fund;
- The name and address of each of the IAs of the trust fund and each of the financial institutions acting in an advisory capacity for the trust fund;
- The identification of each participating local government in the trust fund; and
- The total assets of the trust fund as of the date of filing.

Administrators of local government trust funds must also submit quarterly reports as well as annual audits to the Securities Commissioner.⁶⁵

The Code which is located in section 11-53-101, *et seq.*, C.R.S., regulates the offer or sale of commodity contracts that generally fall outside the jurisdiction of the federal Commodity Futures Trading Commission. The Code defines a commodity contract as:

...a contract for the purchase or sale, primarily for speculation or investment purposes and not for use or consumption by the offeree or purchaser, of one or more commodities...⁶⁶

The Code defines a commodity as:

any agricultural, grain, or livestock product or by-product, any metal or mineral (including a precious metal...), any gem or gemstone (whether characterized as precious, semi-precious or otherwise), any foreign currency, and all other goods, articles, products or items of any kind.⁶⁷

⁶³ § 11-51-904(2), C.R.S.

⁶⁴ §§ 11-51-905(3)(a-f), C.R.S.

⁶⁵ §§ 11-51-906(2)(a) and (4)(a), C.R.S.

⁶⁶ § 11-53-102(5), C.R.S.

⁶⁷ § 11-53-102(4), C.R.S.

The Bond Supervision Act was enacted by the General Assembly in the early 1990s, because at the time, there was a growing concern with special districts and municipal and county improvement districts that were either insolvent or threatened with insolvency.⁶⁸ The Bond Supervision Act empowers the Securities Commissioner to regulate and monitor the issuance of municipal bonds.⁶⁹ Generally, municipal bonds are used to raise funds for capital improvement projects for special districts and county improvement districts, which utilize a variety of taxing authorities to generate revenues to cover the repayment of the bonds.

The Bond Supervision Act created a 17-member Colorado Municipal Bond Supervision Advisory Board (Advisory Board). The Advisory Board is comprised of the following individuals:⁷⁰

- Three members of the General Assembly;
- One municipal securities broker-dealer representative;
- One representative of a county;
- One representative of a municipality;
- One representative of a special district;
- One representative of banks that act as indenture trustees for municipal bond offerings;
- One bond counsel representative;
- One real estate developer representative;
- Three members of the general public with experience in municipal financing as investors; and
- Four owners of residential real property located in special districts.

The Advisory Board is responsible for aiding and advising the Securities Commissioner on issues such as the development of policies, rules, orders, standards, criteria and procedures regarding the registration of bond issues.⁷¹

⁶⁸ § 11-59-102(1)(b), C.R.S.

⁶⁹ § 11-59-102(2), C.R.S.

⁷⁰ § 11-59-105(1)(a), C.R.S.

⁷¹ § 11-59-105(2), C.R.S.

Program Description and Administration

The Colorado Division of Securities (Division) and the Securities Commissioner are charged with administration of the Colorado Securities Act (Act), which is created in section 11-51-101, *et seq.*, Colorado Revised Statutes, (C.R.S.).

The Securities Commissioner is also responsible for providing regulatory oversight for the regulation of the Colorado Commodity Code (section 11-53-101, *et seq.*, C.R.S.), the Colorado Municipal Bond Supervision Act (section 11-59-101, *et seq.*, C.R.S.), and Investment Funds (section 24-75-701, *et seq.*, C.R.S.).

The administration of the aforementioned acts is done primarily through the registration of securities, licensing broker-dealers, investment advisors (IAs) and their respective sales representatives as well as conducting audits of the records of regulated entities.

The Act creates a five-member Securities Board (Board) and a 17-member Colorado Municipal Bond Supervision Advisory Board (Advisory Board). Both boards function as Type II boards that serve in an advisory capacity to the Securities Commissioner.

The Act requires the Board to meet quarterly and requires the Advisory Board to meet, at a minimum, annually. In practice, however, the Advisory Board meets twice annually.

The Securities Commissioner is responsible for, among other things, imposing discipline, issuing securities registrations and licenses, rulemaking and policymaking.

In fiscal year 12-13, the Division devoted 26 full-time equivalent (FTE) employees, who are divided into three primary sections: Administrative, Examinations and Enforcement. The FTE are as follows:

- Securities Commissioner;
- Chief Investigator (Criminal Investigator III);
- Investigators (Criminal Investigator II (five total) and Criminal Investigator I (four total);
- Forensic auditors (one Auditor III and one Auditor IV);
- Chief Examiner (Financial Credit Examiner IV);
- Financial Credit Examiner III;
- Financial Credit Examiner II (nine total);
- Program Assistant I; and
- Administrative Assistant II.

Table 1 highlights the total expenditures for the Division in fiscal years 08-09 through 12-13.

Table 1
Total Program Expenditures in Fiscal Years 08-09 through 12-13

Fiscal Year	Total Expenditures
08-09	\$3,296,861
09-10	\$3,327,220
10-11	\$3,375,405
11-12	\$3,675,835
12-13	\$4,064,974

Table 1 shows that the total expenditures remained fairly constant in fiscal years 08-09 through 10-11, then increased in fiscal years 11-12 and 12-13. The increase can largely be attributed to the passage of the federal Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act). The Dodd-Frank Act, among other things, requires IAs that have less than \$100 million in assets under management to be licensed by the individual states, which increased the number of firms under the Division's supervision by more than 100. This increase in licensed IAs under state supervision is responsible for the increase in expenditures in fiscal years 11-12 and 12-13.

Licensing

The Examination section within the Division is responsible for, among other things, licensing broker-dealers, IAs and their respective representatives.

Table 2 highlights the number of licensed broker-dealers and sales representatives.

Table 2
Total Number of Broker-Dealers and Sales Representatives in Calendar Years 2009 through 2013

Calendar Year	New Broker-Dealer Applicants	Broker-Dealer Renewals*	Total Number of Broker-Dealer Licenses*	New Sales Representative Applicants	Sales Representative Renewals*	Total Sales Representatives*
2009	173	2,285	2,249	7,928	145,342	145,022
2010	164	2,240	2,211	7,829	145,511	153,101
2011	147	2,202	2,185	8,665	153,573	163,161
2012	149	2,181	2,148	7,064	163,818	164,646
2013	102	2,134	2,094	7,254	165,433	171,179

* The difference between the new applicants plus the renewals and the total number of licenses are the withdrawals and terminations that occur throughout the year.

As highlighted in Table 2, the number of licensed broker-dealers declined from calendar year 2009 to 2013. Generally, the decrease is attributable to the turbulent financial landscape and industry consolidations.

Table 2 also shows that the total number of sales representatives increased in each of the five calendar years. The increase is attributable to the low fees the Division charges to be licensed as a sales representative in Colorado. In fact, in calendar year 2013, the fee to obtain a license was \$16. Licensing fees range from between \$16 in Colorado to \$250 in Texas.

Sales representatives apply for a license through a national database, which is operated by the Financial Industry Regulatory Authority called the Central Registration Depository (CRD). When completing the application through the CRD, an applicant can check a box for each jurisdiction in which he or she wishes to obtain a license. Since Colorado has inexpensive licensing fees for sales representatives, many choose to become licensed in Colorado, even if they do not have clients in the state.

Importantly, broker-dealers and sales representatives are not always physically domiciled in Colorado. However, if they transact business in Colorado, they must possess a license.

Table 3 illustrates the total number of IAs and investment advisor representatives (IARs).

Table 3
Total Number of Investment Advisors and Investment Advisor Representatives in Calendar Years 2009 through 2013

Calendar Year	New Investment Advisor Applicants	Investment Advisor Renewals*	Total Number of Investment Advisors Licensed by the Division*	New Investment Advisor Representative Applicants	Investment Advisor Representative Renewals*	Total Investment Advisor Representatives Licensed by the Division*
2009	97	639	658	1,164	8,913	9,059
2010	96	639	644	1,151	9,231	9,338
2011	95	644	620	1,314	9,522	9,566
2012	204	798	728	1,297	9,725	10,110
2013	99	722	722	1,619	10,311	10,925

*The difference between the new applicants plus the renewals and the total number of licenses are the withdrawals and terminations that occur throughout the year.

The number of licensed IAs remained fairly stable until calendar year 2011. As previously noted, the increase is attributable to the Dodd-Frank Act, which required IAs with less than \$100 million under management to be regulated by the states.

Additionally, the Division is also responsible for registering securities. Securities can be registered through coordination, qualification or limited offering. Registration by coordination can be completed if the securities are registered with the Securities and Exchange Commission (SEC). A registration statement and accompanying records must be filed with the Securities Commissioner.⁷²

Securities registered by qualification usually indicates that the securities were not registered with the SEC. Securities registered by qualification must include a registration statement containing full and fair disclosure of all material facts respecting the investment offered.⁷³

Limited offering registration is a type of small public offering for firms to issue stocks, for example, to raise business capital. A limited offering registration is authorized if the issuer has its principal office and the majority of its full-time employees in Colorado.⁷⁴ Among other requirements, the issuer must provide information evidencing that at least 80 percent of the net proceeds from the offering will be used in connection with the operations of business in Colorado.⁷⁵

Table 4 highlights the total number of security filings by coordination, qualification and limited offering in fiscal years 08-09 through 12-13.

Table 4
Securities Filings by Coordination, Qualification and Limited Offering in Fiscal Years 08-09 through 12-13

Registration Method	FY 08-09	FY 09-10	FY 10-11	FY 11-12	FY 12-13
Coordination	43	40	64	53	46
Qualification	4	5	6	7	4
Limited Offering	0	0	0	0	0

Noticeably, there were zero securities registered via a limited offering in the past five fiscal years. One plausible explanation is that businesses chose to utilize one of the exempt safe harbors described below.

Additionally, many securities fall within a variety of exemptions, and are therefore not required to register through the Division. More specifically, the passage of the federal National Securities Market Improvement Act of 1999 expanded the exemptions to the registration requirement for securities. These exemptions are primarily reflected in Regulation D and A offerings.

⁷² § 11-51-303(1), C.R.S.

⁷³ § 11-51-304(2), C.R.S.

⁷⁴ § 11-51-304(6), C.R.S.

⁷⁵ § 11-51-304(6), C.R.S.

Regulation D, which was created pursuant to the Securities Act of 1933 ('33 Act) and adopted in 1982, provides the means for small businesses to sell securities through direct public offerings (DPO).⁷⁶ A DPO is a financial tool that enables a company to issue stock directly to investors—without using a broker or underwriter as an intermediary—and avoid many costs associated with “going public” through an initial public offering.⁷⁷

Regulation D has rules (501 through 508) that describe the different types of offerings and set forth guidelines covering the amount of securities that can be sold and the number and type of investors allowed.⁷⁸

Generally, the three most common rules utilized for securities exemptions are 504, 505 and 506. Rule 504 limits securities offerings to \$1 million, Rule 505 limits offerings to \$5 million and Rule 506 permits unlimited offerings.

Additionally, Regulation A is an exemption to the registration requirement for small public offerings of securities that do not exceed \$50 million in any 12-month period.

Other common exemptions from the securities registration requirement are mutual funds and unit investment trusts. A mutual fund is an investment vehicle that is comprised of a pool of funds collected from many investors for the purpose of investing in securities such as stocks, bonds and money market instruments.⁷⁹

A unit investment trust is an investment that offers a fixed, unmanaged portfolio, generally of stocks and bonds, as redeemable “units” to investors for a specific period of time.⁸⁰ It is designed to provide capital appreciation and/or dividend income.

Importantly, issuers of securities that fall under the many exemptions from registration must provide notice to the Division that the securities are being offered in Colorado. Doing so ensures that the Division is aware of the exempt securities being offered to consumers in Colorado.

⁷⁶ Answers.com. *Regulation D - Reg D: Definition from Answers.com*. Retrieved August 26, 2014, from <http://www.answers.com/topic/regulation-d>

⁷⁷ Answers.com. *Regulation D - Reg D: Definition from Answers.com*. Retrieved August 26, 2014, from <http://www.answers.com/topic/regulation-d>

⁷⁸ Answers.com. *Regulation D - Reg D: Definition from Answers.com*. Retrieved August 26, 2014, from <http://www.answers.com/topic/regulation-d>

⁷⁹ Investopedia.com. *Mutual Fund Definition*. Retrieved August 26, 2014, from <http://www.investopedia.com/terms/m/mutualfund.asp>

⁸⁰ Investopedia.com. *Unit Investment Trust (UIT) Definition*. Retrieved August 26, 2014, from <http://www.investopedia.com/terms/u/uit.asp>

Table 5 illustrates the total number of exempt securities filings for which the Division received notice in fiscal years 08-09 through 12-13.

Table 5
Total Securities Filings Exempt from Registration in Fiscal Years 08-09 through 12-13

Types of Exemptions	FY 08-09	FY 09-10	FY 10-11	FY 11-12	FY 12-13	Total
Regulation D - Rule 504	11	27	34	17	24	113
Regulation D - Rule 505	3	10	17	15	12	57
Regulation D - Rule 506	1,489	1,576	1,574	1,608	1,804	8,051
Regulation A	0	0	2	3	2	7
Mutual Funds Initial Offering	40	60	68	55	63	286
Mutual Funds Renewal	1,546	1,446	1,392	1,369	1,335	7,088
Unit Investment Trusts	905	1,062	1,200	1,268	1,286	5,721

Table 5 illustrates that the highest number of exempt filings for securities were Regulation D, Rule 506 and the renewal of mutual funds.

In Colorado, the Division has jurisdiction over Title 32 municipal bond offerings. All Title 32 municipal bond offerings, unless exempt from registration under the Act, are required to secure a registration through the Division. During fiscal years 08-09 through 11-12, all municipal bond offerings have fallen within one of the available exemptions. Generally, the exemptions require the issuing districts (special or county improvement) to structure their offerings to provide market-appropriate ownership, usually by institutional investors (such as banks).

Notwithstanding the registration exemption, the issuing districts are required to provide notice to the Division that the bonds are being offered.

Table 6 highlights the total number of municipal bond filings in fiscal years 08-09 through 12-13.

Table 6
Total Municipal Bond Filings in Fiscal Years 08-09 through 12-13

	FY 08-09	FY 09-10	FY 10-11	FY 11-12	FY 12-13
Number of Filings	100	112	133	119	115
Total Size of Filings	\$721,237,867	\$737,375,640	\$2,346,094,943	\$829,474,719	\$1,282,983,796

The increase in the number of filings and size of the filings in fiscal year 10-11 was due to the anticipation of the passage of proposed ballot initiatives 60, 61 and 101, which would have essentially limited the authority of municipalities to float debt. These amendments did not pass.

Local government investment pool trust funds are also required to register with the Division. The purpose of these trust funds is to allow local governments to enjoy greater diversity of investments. The funds are limited to the kinds of investments that may be made, usually safe, highly rated investment products. Each pool is required to have an IA managing the pool. The Securities Commissioner is charged with overseeing the IA's management of these pools. Table 7 highlights the total number of local government investment pool trust funds as well as the monetary value in fiscal years 08-09 through 12-13.

Table 7
Total Number of Local Government Investment Pool Trust Funds in Fiscal Years 08-09 through 12-13

Fiscal Year	Registered Local Government Investment Trust Fund Pools	Quarterly Reported Assets—Minimum	Quarterly Reported Assets—Maximum
08-09	3	\$4,945,765,229	\$6,496,011,337
09-10	2	\$5,000,103,690	\$6,285,456,407
10-11	2	\$4,635,590,153	\$5,795,355,725
11-12	2	\$4,057,738,701	\$5,628,983,358
12-13	2	\$4,430,610,405	\$5,950,807,884

As Table 7 illustrates, the number of local government investment pool trust funds has remained constant since fiscal year 09-10.

Examinations

The Division does not itself administer examinations for broker-dealers, IAs and their respective representatives. There are a variety of securities examinations available to broker-dealers and their sales representatives. For example, there is a Series 7 examination, which is a New York Stock Exchange-generated examination for anyone employed by a broker-dealer who will trade all types of securities.⁸¹ The Series 7 examination is the most comprehensive of the registered sales representative examinations.⁸²

Once a broker-dealer or sales representative passes any examination required by FINRA or the SEC, he or she registers with the SEC. This is accomplished by completing an SEC application (Uniform Application for Broker-Deal Registration) for broker-dealers and a U-4 application (Uniform Application for Securities Industry Registration). The applications are electronically submitted through the Central Registration Depository (CRD), which is operated by FINRA and maintained by National Association of Securities Dealers.

The forms allow broker-dealers and sales representatives to literally check the states in which they wish to be regulated. Colorado is an attractive location for broker-dealers to become licensed because of relatively inexpensive licensing fees. Currently, the license fee for a Colorado broker-dealer license is \$80, while a sales representative license is \$16.

The Division reviews the licensing applications through the CRD, and if there are no issues with the license (e.g., past disciplinary actions) the license request is approved and a license is issued.

Broker-dealer and sales representative licenses must be renewed annually.

In order to obtain a license from the Division, IAs must submit an application (Form ADV - Uniform Application for Investment Advisor Registration) through the Investment Advisor Registration Depository (IARD). The IARD is an electronic filing system sponsored by the SEC and North American Securities Administrators Association (NASAA), with FINRA serving as the developer and operator of the system.⁸³

The current licensing fee for IAs is \$80.

⁸¹ Securities Exam Preparation, Inc. *Series 7 Exam Products*. Retrieved August 28, 2014, from <http://www.securitiesexam.com/products/series7.html> Securities

⁸² Securities Exam Preparation, Inc. *Series 7 Exam Products*. Retrieved August 28, 2014, from <http://www.securitiesexam.com/products/series7.html>

⁸³ Investment Advisor Registration Depository. *What is IARD?* Retrieved August 19, 2014, from <http://www.iard.com/WhatIsIARD.asp>

In Colorado, the Act also requires IARs to secure a license from the Commissioner. Investment advisor representatives must submit an application (U-4 - Uniform Application for Securities Industry Registration) for licensure through the IARD. Generally, a candidate for licensure must pass a Series 65 Examination - (Uniform Investment Advisor Law Examination), which is administered by the NASAA, within a two-year period immediately preceding the date of the application for licensing.⁸⁴

The current license fee for IARs is \$16.

The Series 65 examination consists of 140 questions, and a candidate must complete the examination in 180 minutes.⁸⁵

The Series 65 examination has four main content areas:⁸⁶

- Economic factors and business information (14 percent of examination);
- Investment vehicle characteristics (24 percent of examination);
- Client investment recommendations and strategies (31 percent of examination); and
- Laws, regulations and guidelines, including prohibition of unethical business practices (31 percent of examination).

The Series 65 examination is offered at Prometric and Pearson VUE test centers in Colorado. The fee to take the examination is \$155.⁸⁷ Prometric tests centers are in the following locations in Colorado: Colorado Springs, Denver, Grand Junction and Longmont.

Pearson VUE test center locations include: Greenwood Village, Pueblo and Westminster.

IA and IAR licenses must be renewed annually.

⁸⁴ Department of Regulatory Agencies, Division of Securities. Rules Under the Colorado Securities Act. Rule 51-4.4(IA)E.

⁸⁵ North American Securities Administrators Association. *Series 65 & 66 Resources*. Retrieved August 28, 2014, from <http://www.nasaa.org/industry-resources/exams/series-65-66-resources/>

⁸⁶ North American Securities Administrators Association. *NASAA Investment Advisor Competency Examination (Series 65) Exam Specifications and Outline*. Retrieved August 28, 2014, from <http://www.nasaa.org/wp-content/uploads/2011/08/Series-65-Exam-Specification.pdf>

⁸⁷ North American Securities Administrators Association. *Series 65 Study Guide*. Retrieved August 28, 2014, from <http://www.nasaa.org/industry-resources/exams/series-65-66-resources/series-65-study-guide/>

Audits

The Examination Section within the Division is responsible for conducting periodic audits of licensees (e.g., broker-dealers, IAs and their respective sales representatives) and registered Local Government Investment Pool Trust Funds. The goal of audits is to ensure that licensees are complying with the Act in order to prevent dishonest and unethical sales practices.

There are two types of audits utilized by the Examination Section: desk and on-site. Desk audits usually entail reviewing information such as complaint/case files, if any, the names of licensed representatives and principals, advertising and websites.

The on-site examination is a comprehensive review of the licensee to ensure compliance with the Act and applicable rules. During an on-site audit, the examiner, among other things, reviews a range of documentation, including but not limited to:

- Policy and procedures manual;
- List of all principals;
- List of recent hires and recent terminated employees;
- Complaint and correspondence files;
- List of discretionary accounts; and
- Financial statements.

Generally, audits of licensees are completed every four to five years. However, if there are increased risk factors for a licensee, examiners may increase the frequency of audits.

Table 8 delineates the total number of audits completed by the Examination Section in fiscal years 08-09 through 12-13.

Table 8
Total Number of Audits Completed by Division Staff in Fiscal Years 08-09 through 12-13

Fiscal Year	Number of Audits
08-09	50
09-10	68
10-11	64
11-12	110
12-13	175

The data in Table 8 show a substantial increase in the number of audits in fiscal year 11-12. As previously noted, this increase is attributable to the passage of the federal Dodd-Frank Act that, among other things, requires the Division to regulate, and therefore, audit, in excess of 100 additional IAs.

Complaints/Disciplinary Actions

The Act establishes prohibited business practices, which include fraud in connection with the offer, sale or purchase of any security.⁸⁸ Further, section 11-51-501(1), C.R.S., prohibits the employment of any device, scheme or artifice to defraud, the making of any untrue or material fact or omission of a material fact that is necessary to make the statements made, in light of the circumstances under which they are made, not misleading; and engaging in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.

Any person who willfully violates Colorado's anti-fraud provisions is guilty of a Class 3 felony, which is punishable by 4 to 12 years' imprisonment and/or a fine of between \$3,000 and \$750,000.⁸⁹

Additionally, any person who willfully violates any other provision of the Act commits a Class 6 felony, which is punishable by 12 to 18 months imprisonment and/or a fine of between \$1,000 and \$100,000.

The Division receives complaints from a variety of sources, such as the audits conducted by the Examination Section where misconduct is discovered or through investor complaints. The types of violations can range from minor licensing and/or registration violations, up to criminal violations of the Act's anti-fraud provisions.

Once a complaint is received, the Enforcement Section within the Division is responsible for conducting an investigation. Staff begins a preliminary investigation to determine whether the allegations are provable. If there are provable allegations that constitute a violation of the Act, the staff will then open a case and conduct an investigation by subpoenaing documents, interviewing witnesses and garnering other pertinent information.

Division staff may contact and/or work with or refer cases as appropriate to federal authorities, such as the SEC or the U.S. Attorney, as well as regulators from other states. The federal authorities typically take cases with national implications, such as corporate fraud or insider trading, and the Division typically retains cases where a majority of the investors or investments are located in Colorado.

If a determination is made that a violation occurred and that sanctions are warranted, administrative and civil enforcement proceedings are referred to the Colorado Attorney General's Office (AGO). Criminal cases are referred to the appropriate district attorney, the AGO or the U.S. Attorney.

⁸⁸ § 11-51-501(1), C.R.S.

⁸⁹ § 11-51-603(1), C.R.S.

There have been a number of complaints filed against regulated entities in Colorado in fiscal years 08-09 through 12-13. Table 9 highlights the total number of complaints to the Division in the past five fiscal years.

Table 9
Total Number of Complaints to the Division in Fiscal Years 08-09 through 12-13

Nature of Complaints	FY 08-09	FY 09-10	FY 10-11	FY 11-12	FY 12-13
Securities Fraud by Unlicensed/Unregistered Person	64	62	49	54	58
Unregistered Securities	46	41	59	44	35
Fraud by Licensee	28	17	14	9	6
Unlicensed Broker-Dealer/Representative	6	12	10	15	12
Unlicensed Investment Advisor/Representative	4	12	7	9	8
Broker-Dealer/Representative Abuse (e.g., rule violations, sales practice)	48	35	11	14	10
Investment Advisor/Representative Abuse	13	10	12	6	3
Commodities Violations	1	6	5	2	4
Others	57	41	35	38	24
Total Number of Complaints	267	236	202	191	160
Total Cases Opened*	141	129	111	107	92

*The total number of complaints is greater than total cases opened in each of the fiscal years indicated because cases often contain several complaints on various issues.

As Table 9 indicates, the highest number of complaints to the Division in the past five fiscal years related to “securities fraud by unlicensed/unregistered persons.” These cases are generally investment opportunities that are offered and sold outside of the securities industry and include products or schemes such as Ponzi schemes, promissory note investments, oil and gas investments and real estate investments.

Also, Table 9 shows a number of complaints in the “others” category. An example of a case that falls into the “others” category is when the Division receives a complaint involving a non-securities related insurance product.

Table 10 shows the total number of final dispositions ordered by the Securities Commissioner in fiscal years 08-09 through 12-13.

Table 10
Final Dispositions in Fiscal Years 08-09 through 12-13

Type of Action	FY 08-09	FY 09-10	FY 10-11	FY 11-12	FY 12-13
Criminal Referrals	5	14	14	6	10
Grand Jury Indictment/Information Filed	5	7	8	8	10
Convictions	6	9	10	6	8
Civil Enforcement Complaint	11	24	24	15	23
Broker-Dealer/Representative Sanctions (non-revocation)	2	4	2	3	2
Cease and Desist Orders	35	38	21	27	28
Judgments	10	16	10	18	13
Broker-Dealer/Representative License Revocation or Denial	1	4	14	8	3
Injunctions/Temporary Restraining Orders	37	14	16	17	16
Investment Advisor/Representative Revocation or Denial	4	0	2	0	3
Consent Orders	51	15	15	14	34
Restitution Orders	6	9	9	6	9
Warning Letters	6	3	4	7	7
Others	2	6	6	2	4
Totals	181	163	155	137	170

As highlighted in Table 10, the most used form of discipline were cease and desist orders. Generally, cease and desist orders are issued when broker-dealers, IAs or their representatives are conducting business in Colorado without the required license.

Also, there were a number of civil enforcement actions, where the complaint is filed in Denver District Court and the court is asked to enjoin the defendant from future violation of the Act and order restitution to be paid back to investors. These cases usually involve violations of the anti-fraud provisions of the Act, but where conduct does not amount to a criminal violation.

During the past five fiscal years there were 67 judgments against regulated securities professionals. Generally, a judgment is a court order to the defendant in a lawsuit to pay the complaining party a specified sum of money.⁹⁰

The “others” category includes issues such as appellate decisions or final orders entered in administrative registration cases.

Table 11 illustrates the total value of restitution orders, and the actual amount of money recovered to be paid back to investors, obtained by the Division in fiscal years 08-09 through 12-13.

Table 11
Total Value of Restitution Orders and Money Recovered in Fiscal Years 08-09 through 12-13

Fiscal Year	Restitution Orders	Total Value of Restitution Recovered
08-09	\$12,139,491	\$161,500
09-10	\$3,206,423	\$234,710
10-11	\$45,233,363	\$2,795,165
11-12	\$38,252,414	\$6,357,385
12-13	\$32,899,730	\$869,287

⁹⁰ Investopedia.com. *Judgment Definition*. Retrieved September 4, 2014, from <http://www.investopedia.com/terms/j/judgement.asp>

Analysis and Recommendations

Recommendation 1 – Continue the Division of Securities and the Securities Board for 11 years, until 2026.

The Division of Securities (Division), under the administration of the Securities Commissioner, and the Securities Board (Board) provide regulatory oversight of the securities industry in Colorado.

The Division is responsible for registering securities (unless exempt) and ensuring exempt securities submit a filing notice to the Division. Generally, registering securities entails submitting information to the Division such as a company's latest prospectus, a copy of the articles of incorporation and bylaws and a copy or description of the security to be offered to the public.

A filing notice ensures that the Division is aware that an exempt security is being offered to Colorado investors.

Additionally, the Division licenses broker-dealers (firms), sales representatives (individuals), investment advisors (IAs) and investment advisor representatives (IARs).

Broker-dealers are required to submit a BD form (Uniform Application for Broker-Dealer Registration), which is utilized by the Financial Industry Regulatory Authority (FINRA). The form is submitted electronically through the Central Registration Depository (CRD). When submitted through the CRD, the Division, simultaneously with FINRA, receives the application. If there are not issues with the application (e.g., pending discipline) the Division approves the license of the broker-dealer. Completing the BD form through the CRD means that broker-dealers are registered through FINRA and regulated by the Securities and Exchange Commission (SEC) as well as licensed by the Division.

Sales representatives are required to submit a U-4 form (Uniform Application for Securities Industry Registration) through the CRD. Generally, if there are not issues with the application (e.g., pending discipline), the Division approves the license of the sales representative. FINRA also regulates sales representatives.

The licensing process for IAs is similar to broker-dealers. In order to secure a license in Colorado, IAs must complete an application (Form - ADV - Uniform Application for Investment Advisor Registration) through the Investment Advisor Depository (IARD). The IARD is an electronic filing system sponsored by the SEC and the North American Securities Administrators Association. Once the form is submitted through the IARD, assuming there are no issues with the application, the Division approves the license.

Regulatory oversight of IAs is dependent on the total value of the assets under management. The SEC regulates IAs with more than \$100 million in assets under management, and the Division regulates IAs with less than \$100 million in assets under management.

IARs are required to submit a U-4 form (Uniform Application for Securities Industry Registration).

The Division is also responsible for imposing discipline on licensees for violations of the Colorado Securities Act (Act) and applicable rules.

When necessary, the Securities Commissioner utilizes the Board to act as a hearing panel for cease and desist hearings. The Board has provided valuable information to the Commissioner on a variety of issues, including the promulgation of rules.

The 17-member Municipal Bond Supervision Advisory Board advises the Securities Commissioner on issues such as the development of policies, rules, orders, standards criteria and procedures regarding the registration of municipal bonds.

The Division conducts periodic audits of licensees as well. Audits ensure that, among other things, licensees conduct business in accordance with existing securities laws.

The aforementioned functions of the Division assist in the overall protection of investors and, more generally, consumers in Colorado. As evidenced in this sunset review, the Securities Commissioner utilized a variety of disciplinary actions on licensees for violations of the Act and applicable rules. For example, the Securities Commissioner imposed a total of 149 cease and desist orders in fiscal years 08-09 through 12-13. Cease and desist orders are generally issued when a broker-dealer, sales representative, IA or IAR is practicing without the required license.

Additionally, the Securities Commissioner issued several restitution orders, where funds were recovered to be paid back to Colorado consumers. For example, in fiscal year 11-12, the Securities Commissioner ordered \$38,252,414 to be paid back to Colorado investors. The total restitution recovered and ultimately paid back was \$6,357,385.

The first sunset review criterion asks whether regulation is necessary to protect the health, safety and welfare of the public. The securities industry is complex, and there are huge amounts of investor funds that can be vulnerable to risks such as fraud. As such, a comprehensive regulatory structure is essential. The regulatory structure in Colorado does serve to provide adequate protection to consumers.

As reflected in this sunset report, the current system of regulation in Colorado, including the utilization of the Board, is working well and provides adequate and appropriate protection to consumers in the securities marketplace. As a result, the General Assembly should continue the Division and the Board for 11 years, until 2026.

Recommendation 2 – Require securities offered in Colorado pursuant to federal Regulation A of the Securities Act of 1933 to be registered by coordination.

Currently, securities offered in Colorado pursuant to Regulation A of the Securities Act of 1933 ('33 Act) are exempt from registration. Specifically, section 11-51-308(1)(p), Colorado Revised Statutes, (C.R.S.), provides an exemption from registration by requiring the issuer of the securities to provide notice to the Division that the securities are being offered in Colorado and pay the applicable fee.

The purpose of Regulation A is to allow the SEC to create exemptions from registration of securities for “small issues.” In fact, until recently, Regulation A permitted unregistered public offerings of up to \$5 million of securities during a 12-month period.

However, the Jobs Act of 2012, which was enacted by Congress, amended Regulation A by increasing the annual offering limits for securities issued from \$5 million to \$50 million. The substantial increase in the dollar amount issued under Regulation A increases the potential financial risk to Colorado investors. As a result, Regulation A offerings in Colorado should be required to register with the Division. Doing so would enable Division staff to proactively review securities that are offered to investors under Regulation A.

Colorado is only one of two states (the other is New York) that do not require Regulation A securities to be registered.

Given the expansion of the cap on the amount of the offering under Regulation A from \$5 million to \$50 million, requiring registration of these offerings will promote the goal of investor protection and will contribute to the success of a public marketplace for these offerings. More specifically, requiring Regulation A offerings to register with the Division will empower the Division to conduct a review of the securities prior to issuance of the securities to Colorado investors. Doing so will ensure that Colorado investors are being protected by the Division.

As such, the General Assembly should amend section 11-51-308(1)(p), C.R.S., to require Regulation A offerings to be registered by the Division before offerings are open to consumers.

Recommendation 3 – Repeal the licensing fee cap for sales representatives and investment advisor representatives.

Currently, section 11-51-404(1)(a), C.R.S., requires applicants for a license as sales representatives and IARs to pay a licensing fee. However, this section provides that the fee cannot exceed \$25.

The licensing fee for both sales representatives and IARs is \$16. However, if the Division would need to raise fees to cover costs, both direct and indirect, this limitation in the Act could be problematic.

As such, the General Assembly should remove the fee limitation requirement in the Act. Importantly, this recommendation does not give the Division unfettered discretion to arbitrarily increase licensing fees. Section 11-51-707, C.R.S., requires the Division to set its fees for a fiscal year so that the revenue generated from the fees approximates its direct and indirect costs.

Recommendation 4 – Make technical changes to the Act.

Several references in the Act need to be updated and clarified to reflect current practices, conventions and technology. While recommendations of this nature generally do not rise to the level of protecting the health, safety and welfare of the public, unambiguous laws make for more efficient implementation.

Consequently, the General Assembly should make the following technical changes to the Act:

- In sections 11-51-201(3) and 11-51-201.5(1), C.R.S., replace the name “national association of securities dealers” with “financial industry regulatory authority.”
- In section 11-51-201(20)(c), C.R.S., add the words “savings association” between “loan association” and “credit union.”
- In section 11-51-702.5(2)(b), C.R.S., remove “except that initial appointments shall begin January 1, 1995, and one of the members initially appointed pursuant to paragraph (a) and one of the members initially appointed pursuant to paragraph (c) of subsection (1) of this section shall serve until July 1, 2000, the member initially appointed pursuant to paragraph (b) of subsection (1) of this section shall serve until July 2001, and the other members initially appointed shall serve until July 1999.”
- In section 11-51-702.5(2)(f), C.R.S., remove “On and after July 1, 2004.”